



0000012541

ORIGINAL 28

Arizona Corporation Commission

BEFORE THE ARIZONA CORPORATION COMMISSION

DEC 22 2000

DOCKETED BY

CR

AZ CORP COMMISSION  
DOCUMENT CONTROL

CARL J. KUNASEK

Chairman

JIM IRVIN

Commissioner

WILLIAM A. MUNDELL

Commissioner

IN THE MATTER OF THE APPLICATION  
OF U S WEST COMMUNICATIONS, INC.,  
A COLORADO CORPORATION, FOR A  
HEARING TO DETERMINE THE EARNINGS  
OF THE COMPANY, THE FAIR VALUE OF  
THE COMPANY FOR RATEMAKING  
PURPOSES, TO FIX A JUST AND  
REASONABLE RATE OF RETURN THEREON  
AND TO APPROVE RATE SCHEDULES  
DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. T-01051B-99-0105

RESPONSE OF STAFF AND QWEST  
TO SUGGESTED REVISIONS OF  
RUCO, COX AND AT&T

The Staff of the Commission and Qwest Corporation hereby  
respond to the specific suggested revisions to the Settlement  
Agreement and Price Cap Plan submitted by the Residential Utility  
Consumer Office ("RUCO"), Cox Arizona Telecom, L.L.C. ("Cox") and  
AT&T Communications of the Mountain States, Inc. ("AT&T") in  
their briefs. References in this response are to the page and  
lines of the brief at which the suggested revision occurs.  
Attached to this Response as Exhibit A is a Second Revised  
Settlement Agreement and Price Cap Plan incorporating the changes  
discussed herein.

1 RUCO

2 1. Page 14, line 14 through page 15, line 2.

3 Both the changes proposed by RUCO here were made in the  
4 revised Settlement Agreement and Price Cap Plan ("The Revised  
5 Agreement and Plan") submitted by Staff and Qwest on December 18,  
6 2000.

7 2. Page 15, lines 3 through 9.

8 This proposed change is similar to one made by Staff and  
9 Qwest in the Revised Agreement and Plan. Staff and Qwest have  
10 agreed to adopt RUCO's language on that point and have included  
11 it in the Second Revised Settlement Agreement and Price Cap Plan.  
12

13 3. Page 15, line 10 through line 22.

14 This proposed change is similar to one already made by Staff  
15 and Qwest to the Revised Agreement at page 6.

16 4. Page 16, line 1, through Page 17, line 4.

17 This proposed change relates to the interpretation of A.A.C.  
18 R14-2-1103.C. rather than to the Revised Agreement and Plan and  
19 should be dealt with when the issue arises during implementation  
20 of the Revised Agreement and Plan.

21 COX

22 1. Page 1 Of 2, 1)c)v)

23 Staff and Qwest agree to add to the Revised Agreement the  
24 following language " and price floors for individual services  
25 must meet the pricing requirements of A.A.C. R14-2-1103.C."  
26

1 Staff and Qwest decline to add the rest of Cox's proposed  
2 sentence since that change is inconsistent with A.A.C. 14-2-  
3 1103.C. and 14-2-1109.A.

4 2. Page 1 of 2 , 4)a)

5 Staff and Qwest decline to make this change for the reasons  
6 stated in their posthearing briefs.

7 3. Page 1, of 2, 4)e)

8 Staff and Qwest decline to make the first change contained  
9 in this proposed paragraph for the reasons stated in their  
10 posthearing briefs.

11 Cox's second proposed additional change is identical to the  
12 change described in paragraph 1)c)v) and Staff and Qwest will  
13 make the same changes described in the response to that proposal.

14 4. Page 2 of 2 4)e)ii)

15 The Revised Agreement and Plan contain this change proposed  
16 by Cox.

17 5. Page 2 of 2, 4)f)

18 Cox's proposed change is substantially identical to the  
19 change it has proposed to paragraph 1)c)v) and Staff and Qwest  
20 will make the same changes described in the response to that  
21 proposal.  
22  
23  
24  
25  
26

6. Page 2 of 2, 4) g) .

Staff and Qwest decline to make this change for the reasons stated in their testimony in support of the settlement and posthearing briefs.

7. Page 2 of 2, 4(i)

Staff and Qwest decline to make this change to the Revised Agreement and Plan

AT&T

1. Page 18, second full paragraph

Staff and Qwest decline to make the changes proposed by AT&T because AT&T has not proposed any specific definitions for inclusion in the Agreement. The Revised Agreement and Plan have corrected the inconsistent references to "Price Index" and "Price Cap Index" contained in 2(b) of the Price Cap Plan.

2. Page 18, third full paragraph

AT&T is correct that the cross-reference in Paragraph 2 of the Price Cap Plan should be to Paragraph 5 and not Paragraph 6. This error has been corrected in the Revised Agreement and Plan.

3. Page 18, last paragraph,

Staff and Qwest believe that the changes made in response to RUCO proposal number 1 and Cox proposal 1)c)v) adequately address this proposal of AT&T.

1           4.    Page 19, first full paragraph

2           Staff and Qwest accept this proposal and language has been  
3 added to the Second Revised Agreement and Plan to incorporate  
4 this change.

5           5.    Page 19, second full paragraph.

6           Staff and Qwest decline to accept this proposed change from  
7 AT&T and believe that this issue is addressed by the 30 day  
8 review process contained in Paragraph 4(e) of the Price Cap Plan.

9           6.    Page 19, third full paragraph.

10           Staff and Qwest have included language in the Second Revised  
11 Settlement Agreement and Price Cap Plan to address AT&T's  
12 concerns expressed in this paragraph.

13           7.    Page 19, last paragraph

14           Staff and Qwest decline to accept this proposed change from  
15 AT&T and believe that this issue is addressed by the 30 day  
16 review process contained in Paragraph 4(e) of the Price Cap Plan.

17           Finally, Staff and Qwest decline to accept any of the  
18 changes proposed by AT&T in Section I of its posthearing brief.  
19  
20  
21  
22  
23  
24  
25  
26

1 RESPECTFULLY SUBMITTED this 22nd day of December, 2000.

2 FENNEMORE CRAIG, P.C.

3  
4 By

Timothy Berg  
Timothy Berg  
Theresa Dwyer  
3003 North Central, Suite 2600  
Phoenix, Arizona 85012  
Attorneys for Qwest Corporation

8 ARIZONA CORPORATION COMMISSION

9  
10 By

Maureen A. Scott  
Maureen Scott  
Legal Division  
1200 West Washington  
Phoenix, Arizona 85007

13 ORIGINAL AND TEN of the foregoing  
14 filed this 22nd day of  
15 December, 2000, with:

16 Docket Control  
17 ARIZONA CORPORATION COMMISSION  
1200 West Washington  
Phoenix, Arizona 85007

18 COPY of the foregoing hand-delivered  
19 this 22nd day of December, 2000, to:

20 Deborah Scott  
21 Director, Utilities Division  
22 ARIZONA CORPORATION COMMISSION  
1200 West Washington  
Phoenix, Arizona 85007

1 COPY of the foregoing e-mailed and  
2 sent regular mail this \_\_\_\_ day  
3 of December, 2000, to:

4 Jane L. Rodda  
5 Acting Chief Administrative Law Judge  
6 Hearing Division  
7 ARIZONA CORPORATION COMMISSION  
8 400 West Congress St.  
9 Tucson, Arizona 85701

10 Scott S. Wakefield, Chief Counsel  
11 Residential Utility Consumer Office  
12 2828 N. Central Ave., Suite 1200  
13 Phoenix, AZ 85004-1022

14 Darren S. Weingard  
15 Natalie D. Wales  
16 Sprint Communications Company, L.P.  
17 1850 Gateway Drive, 7<sup>th</sup> floor  
18 San Mateo, CA 94404-2467

19 Steven J. Duffy  
20 Ridge & Isaacson, P.C.  
21 3101 N. Central Ave., Suite 432  
22 Phoenix, AZ 85012

23 Raymond S. Heyman  
24 Randall H. Warner  
25 Roshka Heyman & DeWulf  
26 Two Arizona Center  
400 N. Fifth St., Suite 1000  
Phoenix, AZ 85004

19 Peter Q. Nyce, Jr.  
20 General Attorney, Regulatory Law Office  
21 U.S. Army Legal Services Agency  
22 Department of the Army  
23 901 N. Stuart St., Suite 700  
24 Arlington, VA 22203-1837

25 Richard Lee  
26 Snavelly, King, Majoros, O'Connor & Lee, Inc.  
1220 L St., N.W., Suite 410  
Washington, D.C. 20005

Thomas F. Dixon  
MCI WorldCom

- 1 707 17<sup>th</sup> St., Suite 3900  
Denver, CO 80202
- 2
- 3 Thomas H. Campbell  
Lewis & Roca  
40 N. Central Ave.  
4 Phoenix, AZ 85004
- 5 Richard S. Wolters  
AT&T  
6 1875 Lawrence St., Suite 1575  
7 Denver, CO 80202
- 8 Mary B. Tribby  
AT&T  
9 1857 Lawrence St., Ste. 1575  
Denver, CO 80202
- 10
- 11 Mark J. Trierweiler  
AT&T  
12 111 West Monroe, Ste. 1201  
Phoenix, AZ 85003
- 13 Diane Bacon, Legislative Director  
14 Communications Workers of America  
Arizona State Council  
15 5818 N. 7<sup>th</sup> St., Suite 206  
Phoenix, AZ 85014-5811
- 16
- 17 Michael W. Patten  
BROWN & BAIN, P.A.  
2901 North Central Avenue, Suite 2000  
18 Phoenix, Arizona 85001-0400
- 19 Michael M. Grant  
Todd C. Wiley  
20 Gallagher & Kennedy, P.A.  
2575 East Camelback Road  
21 Phoenix, AZ 85016-9225
- 22
- 23
- 24 Jeffrey Crockett  
Snell & Wilmer  
One Arizona Center  
25 Phoenix, AZ 85004-0001
- 26



- 1 J.E. McGillivray  
300 S. McCormick
- 2 Prescott, AZ 86303
- 3 Jon Poston  
Arizonians for Competition in Telephone Service
- 4 6733 East Dale Lane  
Cave Creek, AZ 85331
- 5
- 6 Albert Sterman  
Vice President
- 7 Arizona Consumers Council  
2849 E. 8<sup>th</sup> Street
- 8 Tucson, AZ 85716
- 9 Douglas Hsiao  
Frank Paganelli
- 10 Rhythms Links, Inc.  
6933 Revere Parkway
- 11 Englewood, CO 80112
- 12 Jim Scheltema  
Blumenfeld & Cohen
- 13 1625 Massachusetts Ave., NW, Suite 300  
Washington, SC 20036
- 14
- 15 Martin A. Aronson  
William D. Cleaveland
- 16 Morrill & Aronson, PLC  
One East Camelback, Suite 340
- 17 Phoenix, AZ 85012-1658
- 18 Joan S. Burke  
Osborn Maledon, P.A.
- 19 2929 N. Central Ave., Suite 2100  
Phoenix, AZ 85012
- 20
- 21
- 22 Mark N. Rogers  
Excell Agent Service, L.L.C.
- 23 2175 W. 14<sup>th</sup> Street  
Tempe, AZ 85281
- 24
- 25 Chuck Turner, Mayor  
Town of Gila Bend
- 26

1 P.O. Box A  
644 W. Pima Street  
2 Gila Bend, AZ 85337-0019

3

4

*Monica A. Marting*

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

## SETTLEMENT AGREEMENT

Qwest Corporation (Qwest) and the Arizona Corporation Commission Staff (Staff) (collectively "the Parties") hereby agree to a settlement (the "Agreement") of the pending Qwest general rate case in Docket No.T-01051B-99-0105 (the Rate Case). The following terms and conditions, including Attachments (A) through (E) appended hereto (hereinafter referred to as the Price Cap Plan), are intended to resolve all of the issues among the Parties associated with the Rate Case.

### RECITALS

WHEREAS, the Parties desire to adopt this Agreement and Price Cap Plan for Qwest to create incentives for Qwest to improve its efficiency, to provide new and innovative service offerings and to reduce the opportunity for cross-subsidization of competitive services by non-competitive services.

WHEREAS, by adopting the Price Cap Plan, the Parties intend to avoid the need for any general rate proceeding for the next three years, provide rate stability to Qwest's Arizona consumers by capping rates for essential services and create an opportunity for Qwest's customers to benefit from productivity improvements in the form of decreased rates.

WHEREAS, the Parties agree that the price caps provided for in this Agreement will ensure that rates for Qwest's telecommunications services are based on the fair value of Qwest's property devoted to the provision of intrastate telecommunications services in Arizona and to result in the establishment of just and reasonable rates for Qwest's Arizona customers; and

WHEREAS, the Parties agree that nothing in this Agreement is intended to in any way restrict or modify the Commission's current authority or jurisdiction over Qwest as provided under Arizona law; and

WHEREAS, the Parties agree that this Settlement is in the public interest.

### TERMS

1. FAIR VALUE RATE BASE AND REASONABLE RATE OF RETURN. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 1999 (the "Test Year") is \$1,446.0 million. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that a reasonable return on the fair value of that rate base is 9.61%. The Parties stipulate to the adoption of the foregoing fair value rate base and reasonable rate of return and agree that the resultant increased revenue requirement, as identified in Section 2 below, results in just and reasonable rates for Qwest.

2. REVENUE REQUIREMENT DEFICIENCY. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties agree that Qwest's jurisdictional revenue requirement deficiency is \$ 42.9 million.

3. RATE DESIGN. The Parties agree that the revenue requirement set forth in Section 2 above shall be recovered through (a) a combination of increases and decreases in rates for services reflected on Attachment B hereto to recover \$ 17.6 million of Qwest's Test Year revenue requirement and (b) the opportunity for revenue from flexibly-priced services contained in Basket 3 of the Price Cap Plan discussed in Section 4 of this Agreement to recover \$25.3 million of Qwest's Test Year revenue requirement. The initial rates set forth on Attachment B include rate adjustments based on Test Year revenue levels as follows:

\$ Million

23.1	Increase revenues from directory assistance rates which shall be capped at \$ 0.85 per call for one year
13.7	Increase in Private Line Services
-5.0	Reduction in Intrastate Access Charges for First Year of Agreement
-7.9	Reduction in Residential Basic Service Nonrecurring Charges from \$ 46.50 to \$ 35.00
-1.5	Revenue Reduction from Basic Residential Service from Change in U-1 Base Rate Area Boundaries
-1.9	Revenue Reduction from Basic Residential Service from Change in U-2 Base Rate Area Boundaries
-2.3	Elimination of Residential Non-recurring Zone Connection Charge
-0.2	Elimination of Business Non-Recurring Zone Connection Charge
-0.2	Revenue Reduction from Basic Business Service From Change in U-1 Base Rate Area Boundaries
-0.2	Revenue Reduction from Basic Business Service From Change in U-2 Base Rate Area Boundaries
<hr/>	
17.6	Overall Immediate Revenue Change
25.3	Increase in available additional revenue in Basket 3 services except directory assistance for one year
<hr/>	
42.9	Overall Net Revenue Change Authorized

The Parties further agree that rates for Intrastate Switched Access Service shall be reduced at the start of the second year of the Price Cap Plan to cause an additional \$ 5 million reduction in revenues from that service and reduced again at the start of the third year of the Price Cap Plan to cause an additional \$ 5 million reduction in revenues. The Parties agree that the revenues available under the Cap for Basket 3 Services, as described in the next Section of this Agreement, shall be increased by \$ 5 million at the start of the second year of the Price Cap Plan and an additional \$ 5 million at the start of the third year of the Price Cap Plan to correspond on a revenue requirement basis to the reduction in access revenues.

The Parties agree that Qwest's Due Date Change Tariff and Start-Up Package Elimination Tariff may be implemented upon Commission approval of this Agreement. The

Parties also agree that all multi-party grades of residential and business basic service should be eliminated. The net effect of the approval of these tariffs and the elimination of multi-party service is to increase Qwest's revenues by \$247,856 and to require investment of approximately \$4 million. These amounts are in addition to the amount set forth in section 2 as the change in revenue requirement.

4. PRICE CAP PLAN. The Parties agree to create a Price Cap Plan, described in this Section and Attachments (A) through (E) appended hereto, as part of the resolution of the Rate Case. The term of the Price Cap Plan shall be three years from the effective date as specified in the Commission's Order approving this Agreement and Price Cap Plan. The Parties agree that the initial rates set forth on Attachment B and the flexibility for Basket 3 Services under the Price Cap Plan result in just and reasonable rates for Qwest's Arizona intrastate operations. Upon approval of this Agreement by the Commission, Qwest will file its intrastate tariffs in accordance with this Agreement, which rates shall take effect as specified in the Commission's order approving of this Agreement and Price Cap Plan.

The Price Cap Plan creates three "baskets" of services. Basket 1 consists of Basic/Essential Non-Competitive Services. The services in Basket 1 are identified on Attachment C to this Agreement. Basket 1 will be capped, using an "Inflation minus Productivity" indexing mechanism, subject to annual updates in the quantity of demand as set forth on Attachment A. As a compromise to the respective positions of the parties, the productivity factor (X) for the initial term of the Plan is set at 4.2%, which includes a 0.5% consumer dividend. The productivity offset for each year of the initial term applied to the Price Index cap for Basket 1 shall be equal to  $(\text{GDP-PI}) - X$ , where zero is equal to or greater than  $(\text{GDP-PI}) - X$ . The parties agree to conduct studies and submit productivity evidence in the

scheduled review of the Plan's initial term. Basket 2 consists of Wholesale Services. The services in Basket 2 are identified on Attachment D to this Agreement. Except as otherwise provided in this Agreement, services in Basket 2 will be capped at the levels existing on the date of execution of this Agreement and will remain subject to the specific pricing rules for those services, as interpreted by the Commission and the Courts. Basket 3 consists of Flexibly-Priced Competitive Services. The Services contained in this Basket are identified on Attachment E to this Agreement. Basket 3 will be capped at an index, subject to annual updates in the quantity of demand, which index will be calculated as set forth in subpart 4(c) of Attachment A. Notwithstanding, the additional revenue level for purposes of headroom in Basket 3, shall be capped at \$25.3 million, on a test year basis, for the term of the Price Cap Plan. Basket 3 will also be subject to an upward adjustment of \$5 million per year in the second year of the Price Cap Plan and an additional \$5 million per year in the third year of the Price Cap Plan to offset the annual reductions to intrastate switched access revenue under this Agreement. The details of the Price Cap Plan and the procedural mechanisms for the implementation of price changes under that Plan are set forth on Attachment A to this Agreement.

Nine months prior to the expiration of the Price Cap Plan, Qwest will submit an application with its recommendation for extension, or revision of the Price Cap Plan for review by Staff, the Residential Utility Consumer Office ("RUCO") and the Commission. The Application will be available for review and comments by other interested parties. The Application will include the following information:

- a. A detailed statement of price and revenue changes effected during the initial term of the Price Cap Plan;

- b. A statement of the aggregate investment and retirements in plant, and associated depreciation for the preceding calendar year;
- c. A statement of the operating income and return on investment for the preceding calendar year;
- d. Service quality comparative data during the initial term of the Price Cap Plan as specified by Staff; and
- e. Updated analysis of productivity data applicable to the Price Cap Plan.

Staff may request and Qwest will provide, pursuant to A.R.S. § 40-204, such other additional information as Staff determines necessary for the analysis of Qwest's application. Staff agrees to withdraw its recommendation concerning a plant modernization credit, subject to a review of Qwest's capital investment during the initial term of the Price Cap Plan.

Renewal or modification of the Price Cap Plan at the end of the initial term is subject to approval by the Commission. Until the Commission approves ~~the~~ a renewal or modified Price Cap Plan, or orders a termination of the Plan after its term, the Plan including the hard caps on Basket One Services set forth in paragraph 2(c)(i) shall continue in effect.

The Parties further agree that if the Federal Communications Commission ("FCC") or the Commission orders, adjusts or raises an assessment for the support of Universal Service during the initial term of the Price Cap Plan, the recovery of that assessment is not subject to the provisions of the Price Cap Plan and Qwest may pass through that assessment in the form of a surcharge(s) without filing a general rate case. Any additional federal or state universal service funding received by Qwest will be considered an adjustment to the price caps established under this Plan.



5. SERVICE QUALITY CREDITS. To ensure service quality during the initial term of the Price Cap Plan, the Parties agree that, for any year in which Qwest becomes subject to penalties under two or more of the five categories defined in Section 2.6 of the Service Quality Plan Tariff [i.e., Section 2.6.1(E) through Section 2.6.1(F)], additional credits shall be implemented after each of the initial three Price Cap Plan years if existing penalties are payable. Such additional credits shall take the form of one-time credits of \$2.00 for each residential and business access line in Arizona. Qwest shall issue these credits no later than March 31 of the year in which the foregoing Section 2.6 penalties are paid. The foregoing credits are additional to any credits and penalties provided by the Service Quality Plan Tariff. No service quality penalties or credits shall be assessed during the initial term of the Price Cap Plan other than those provided for in the Service Quality Plan Tariff as modified by Decision No. 62672 and in this Agreement, except for any wholesale standards and penalties adopted in Docket No. T-00000B-97-0238 or in any other Commission proceeding addressing wholesale service quality standards or penalties.

6. NOTICE TO CONSUMERS. Following Commission approval of the Settlement Agreement and Price Cap Plan, Qwest will provide, in two subsequent bills sent to Qwest's Arizona consumers, information regarding the services for which rates and charges may change without Commission approval. The bill inserts shall also inform Qwest's customers that essential basic services which are part of any packaged offering remain available and can be obtained by the customer as a separate offering. The bill inserts shall also inform consumers that the Arizona Corporation Commission remains the regulatory agency responsible for overseeing the terms, conditions, rates and quality of service provided by Qwest and that complaints regarding any of Qwest's regulated services should be directed to the Commission's Consumer Services Section. The bill inserts will be provided to Staff for its review and approval prior to being sent to

consumers. In connection with the implementation of this Agreement, Qwest will prepare training materials for customer service representatives to use in interfacing with customers in conjunction with the implementation of the Price Cap Plan.

7. MORATORIUM ON AND PROCEEDINGS FOR FUTURE RATE INCREASES. The Parties agree that no Party shall file an application for or complaint seeking an adjustment in Qwest's general rates and charges that would be effective during the initial term of the Price Cap Plan (the "Rate Proceeding Moratorium Period"). The Rate Proceeding Moratorium Period shall be extended for each additional period of extension or revision of the Price Cap Plan.

8. COMMISSION APPROVAL AND SEVERABILITY. Each provision of this Agreement is in consideration and support of all other provisions, and expressly conditioned upon acceptance and approval by the Commission without material change. Unless the Parties to this Agreement otherwise agree, in the event that the Commission fails to accept and approve this Agreement according to its terms, then it shall be deemed withdrawn by the Parties and the Parties shall be free to pursue their respective positions in the Rate Case without prejudice.

9. COMPROMISE. This Agreement represents the Parties' mutual desire to compromise and settle disputed claims and issues regarding the prospective just and reasonable rate levels of Qwest in a manner consistent with the public interest and based upon the pre-filed testimony, and exhibits and the evidentiary record developed in the Rate Case. This Agreement represents a compromise of the positions of the Parties. Acceptance of this Agreement is without prejudice to any position taken by any party in the Rate Case and none of the positions taken herein by any of the Parties may be referred to, cited or relied upon by any other party in any fashion as precedent or otherwise in any proceeding before this Commission or any other regulatory agency

or before any court of law for any purpose except in furtherance of the purposes and results of this Agreement.

10. PRIVILEGED AND CONFIDENTIAL COMMUNICATIONS. All negotiations relating to or leading to this Agreement are privileged and confidential, and no party is bound by any position asserted in negotiations, except to the extent expressly stated in this Agreement. As such, evidence of conduct or statements made in the course of negotiation of this Agreement are not admissible as evidence in any proceeding before the Commission, any other regulatory agency or any court.

11. COMPLETE AGREEMENT. This Agreement represents the complete agreement of the Parties. There are no understandings or commitments other than those specifically set forth herein. The Parties acknowledge that this Agreement resolves all issues that were raised in the Rate Case and is a complete and total settlement between the Parties.

12. SUPPORT AND DEFEND. Each Signatory Party will support and defend this Agreement and any order entered by the Commission approving this Agreement before the Commission or other regulatory agency or before any court in which it may be at issue.

13. APPEALS AND CHANGE OF LAW. The Parties hereto believe that the Settlement Agreement and Price Cap Plan provided for herein are lawful and consistent with the Arizona Constitution and case law interpreting the Arizona Constitution. If the Arizona courts should ultimately find, in a final, nonappealable order, that the Price Cap Plan is unlawful, or there is other significant change in controlling federal and state law, Staff and Qwest shall review the court decision or other change in law and discuss whether the Plan can be modified to meet the order or change in law. Further, Qwest shall have no obligation to refund revenues collected

during the period of time the Price Cap Plan is in effect. If Staff and Qwest are unable to reach an agreement on how to modify the Price Cap Plan, the Plan shall end, and the Commission shall determine the appropriate method of regulation for Qwest.

DATED this 20th day of October, 2000.

ARIZONA CORPORATION COMMISSION  
UTILITIES DIVISION STAFF

BY: \_\_\_\_\_  
Deborah Scott, Director

QWEST CORPORATION

BY \_\_\_\_\_  
Teresa Wahlert, Arizona Vice-President

Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

**Price Cap Plan**

- 1) Baskets
  - a) Basket 1: Basic/Essential Non-competitive Services
  - b) Basket 2: Wholesale Services
  - c) Basket 3: Flexibly-Priced Competitive Services
- 2) Basket 1: Basic/Essential Non-competitive Services
  - a) A list of the individual services in Basket 1 is appended hereto as Attachment C.
  - b) Cap on Basket 1
    - i) The Arizona Corporation Commission ("Commission") Staff recognizes the advantages of an "Inflation minus Productivity" price cap index mechanism. Given the uncertainty of recent interpretations of Arizona law regarding rate increase mechanisms, for the initial three year term of the plan, the weighted average price level (or "Price Index") of all services contained in Basket 1 is capped, using an "inflation minus productivity" indexing mechanism, subject to annual updates in the quantities of demand for each service.
    - ii) The Productivity Offset, which is the X Factor in the formula in subpart 2 b) vi) below, shall be equal to 4.2 percent.
    - iii) The measure of inflation used in the Price Cap Index mechanism is the annual percent change in the Gross Domestic Product Price Index ("GDP-PI"), using a seasonally-adjusted, chained price index, as calculated by the Department of Commerce. The percent change in the GDP-PI from the most recently available quarter and the same quarter from the previous year, shall be the basis for the calculation of inflation in the Price Cap Mechanism. The "Inflation minus Productivity" calculation shall be performed once annually on January 1st.
    - iv) The "Inflation Minus Productivity" calculation shall be capped at zero and has no lower bound. Therefore, the Price Cap Index is capped at 1.00 and has no lower bound.
    - v) In the first quarter of the third year of the Price Cap Plan, Qwest shall file, along with other required materials, productivity evidence for the past 2 years under price regulation.
    - vi) The formula for the Price Cap Index for Basket 1 is:

$$1.00 + \% \Delta \text{GDP-PI} - \text{X Factor} \geq [\text{SUM } [P_N * Q_{e_b}]] / [\text{SUM } [P_{e_b} * Q_{e_b}]]$$

The numerator of the Price Cap Index of Basket 1 is the sum of the proposed/new prices multiplied by the "current base year" quantities of demand. ~~Current demand will be the quantities of demand from the most recent year.~~ Where price changes have not occurred, the ~~current/existing~~ base year price of the service is used. The denominator is the sum of ~~existing~~ base year prices multiplied by the "current base year" quantities of demand.

Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

Section (65) below details the data that Qwest shall provide to enable calculation and monitoring of the cap.

With each price change, Qwest must provide the existing and new price to Staff, as well as Qwest's calculation of the Price Index following implementation of the price change. Staff will use the Price Cap Database to check Qwest's calculation. All price changes must be demonstrated to be within the cap. The Price Cap Index calculation will be cumulative in a given year.

c) Service Pricing Flexibility

- i) Certain Basic services are to be capped at their initial levels throughout the term of the Price Cap Plan. These service prices may be reduced as they are included in the calculation of the Basket 1 Price Index. These services are: flat rate residential; flat rate business; 2 & 4 party service; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks, including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.
- ii) The remaining services in Basket 1 may increase or decrease within the band established by the Price Index.
- iii) Individual service ~~prices~~ rate elements within Basket 1, other than those services listed in subpart i) above [services subject to the hard cap], may increase no more than 25 percent within a year.
- iv) Individual service prices must exceed the service's Total Service Long Run Incremental Cost ("TSLRIC"), unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. Individual service prices must also comply with the imputation requirements of A.C.C. R14-2-1310(c), as applicable.
- v) Changes to Terms and Conditions of services in Basket 1 shall be submitted to the Commission for Staff review and approval. All services in this Basket shall be continued statewide at the tariffed rate, unless or until the Commission orders retail geographic rate de-averaging, or unless Qwest demonstrates a cost difference for a new service on which to base the price difference. Nothing in this Price Cap Plan shall preclude the Commission from deaveraging wholesale rates on a cost basis.
- vi) Price increases for services in this Basket require 30 day notice to the Commission by submission to Staff, and 30 days notice to consumers.

3) Basket 2: Wholesale Services

- a) The services included in Basket 2 at the Price Cap Plan's inception include: Intrastate Carrier Switched Access, Discounted Wholesale Offerings, Unbundled Network Element (UNE) Offerings, Wholesale services such as PAL lines, and all other wholesale offerings unless specifically listed in Attachments C and E as included in either Basket 1 or 3. A list of wholesale services, with the exception of

Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

- UNEs, included in Basket 2 at the Price Cap Plan's inception is contained in Attachment D.
- b) Basket 2 consists of wholesale services many of which are governed by their own specific pricing rules and will continue to be governed by such rules, as interpreted by the Commission and the Courts, under this Price Cap Plan.
  - c) UNEs and discounted Wholesale Offerings are priced based on the provisions of the Telecommunications Act of 1996 (1996 Act), FCC implementing regulations and Commission rules.
  - d) An exception includes Intrastate Switched Access Services which are to be reduced by \$5 million per year for the duration of the initial term of the Plan, with further reductions in Intrastate Switched Access Service rates taking place during any subsequent term of the Price Cap Plan with the objective of obtaining parity with interstate switched access rates.
  - e) Service prices are capped for the term of the Price Cap Plan, or until the specific pricing rules are changed or the Commission determines that other prices are appropriate.
  - f) New wholesale services are to be added to this Basket when those services are implemented.
  - g) ~~Nothing in this Price Cap Plan is intended to change or modify in any way the imputation requirements contained in A.A.C. R14-1-1310.~~
- 4) Basket 3: Flexibly-Priced Competitive Services
- a) This Basket includes only those services that have been accorded pricing flexibility or have been determined by the Commission to be competitive under A.A.C. R14-2-1108, and new services and new service packages offered by Qwest. Any new services and new service packages offered by Qwest shall be subject to the prior review and approval of the Commission, as provided in subpart e) below. A list of services included in Basket 3 at the inception of this Price Cap Plan is appended hereto as Attachment E.
  - b) The price cap for this Basket is the weighted average price level of all the services in the Basket as calculated by the formula set forth in subpart c) following, subject to annual updates in quantities. Notwithstanding, the additional revenue level for purposes of headroom in Basket 3, shall be capped at \$25.3 million, on a test year basis, for the term of the Price Cap Plan. The price cap will be adjusted upward \$5 million in the second year of the Plan and an additional \$5 million in the third year of the Plan, to reflect the switched access charge reductions in those years.
  - c) The formula for the calculating the Price Cap Index for Basket 3 is:

$$1.0 \geq [\text{SUM} (P_n * Q_{eb})] / [\text{SUM} (1.10 * P_{eb} * Q_{eb})]$$

The numerator is the sum of the proposed/or new prices multiplied by the "current base year" demand. ~~Current demand will be demand from the most recent year.~~ Where price changes have not occurred, the ~~current/existing~~ base year price of the

Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

service is used. The denominator is the sum of 110 percent of the existing base year prices multiplied by current base year demand. Pb and Qb are the prices and quantities of the services in the basket in the "base" year of the plan. For new services and packages the Pb and Qb are the price and quantities for the first full year in which the service is offered. See 4(d) below for further explanation of the appropriate data to be used for new services and packages. The 10% increase allowed under the Price Cap Index for Basket 3 is for the term of the Price Cap Plan.

- d) New services and service packages shall be added to the calculation of the price cap index, in both the numerator and denominator, at the end of the year in which they were introduced, to obtain actual experience with the service, so the calculation is not based solely upon projections. Qwest shall provide notification to Staff of the new services/packages and their prices as provided in subpart e) below. Once a full year's worth of actual demand is available for use in the Price Cap Index, that demand should be the "base" year demand to be used.
- e) Any services in Basket 1 may be the components of any new package that would be offered in Basket 3. Each Basket 1 service that is included in a package offered in Basket 3 shall continue to be offered in its current form in Basket 1 as of the commencement of the Price Cap Plan. Such new packages that involve the capped services in Basket 1, or any new services proposed to be included in Basket 3, shall be submitted at least thirty days in advance of the proposed effective date of the tariff of the new package or service and shall be subject to Commission consideration as provided in A.R.S. § 40-250. The Commission retains the right to reject any proposed classification or filing. The price of the new package or service shall exceed the TSLRIC of the package or service and comply with the imputation requirements of A.C.C. R14-2-1310(c). For purposes of combining Basket 1 services with Basket 3 services and setting a floor for that package, the imputed price of 1FR service shall be the applicable existing retail price for that service 1FR.
  - i) Qwest shall be required to inform consumers, through its marketing of such new packages, including through its bill inserts, educational materials and customer representative scripts, that the services in Basket 1 remain available and can continue to be purchased as separate offerings.
  - ii) The mere repackaging of existing Basket 1 services does not qualify the existing services to be "new services." create a "new service" or "new service package" for purposes of the Price Cap Plan.
- f) Individual service and package prices must provide revenues in excess of the service's or package's TSLRIC subject to the provisions of subpart e) above, unless a different cost standard applicable to all telecommunications service providers is determined appropriate by the Commission. The individual service and package prices must also comply with the imputation requirements of A.A.C. R14-2-1310(c).
- g) New services and packages in Basket 3 may be offered to selected customer groups based on their purchasing patterns or geographic location, for example.



Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

- This provision shall not be construed to permit red-lining based on criteria such as wealth or race, or to permit Qwest to discriminate against any class of customers in violation of A.R.S. Section 40-334.
- h) Existing services in Basket 3 shall continue to be offered to existing customer groups. Qwest must receive Commission approval for discontinuation or revision of services, terms and conditions.
  - i) A Basket 1 service may be moved to Basket 3 upon Qwest meeting the criteria of R.14-2-1108. Staff and Qwest agree that Staff will process such an Application as expeditiously as reasonably possible and, in any event, will complete such processing within a period of six months, unless another time period is agreed to by Qwest, or the six month time period is waived by the Commission.
  - j) If a service is moved from Basket 1 to Basket 3 because it has met the criteria of R14-2-1108, the Basket 3 price and quantities for the numerator and the denominator for that service shall be the prices and quantities for that service contained in the numerator of the Basket 1 PCI formula at the time that the service is moved, and the 1.1 factor will not be applied to these services for the remaining term of the plan.
  - k) The Commission's existing rules (A.A.C. R14-2-1109) which prohibit cross-subsidization of competitive services (Basket 3) by non-competitive services (Baskets 1 and 2) shall continue to apply to all services offered by the Company under this Price Cap Plan.
  - l) Price changes to flexibly priced and competitive services contained in Basket 3 shall comply with the requirements of A.A.C. R14-2-1109.
- 5) Annual Filing of Price Cap Data
- a) Price Cap Database: For the first year of the Price Cap Plan, Qwest will file, in electronic form, an Excel spreadsheet that is a database of the prices and quantities of each service in Baskets 1 and 3. The spreadsheet will include the formula for calculating the index of Baskets 1 and 3. The spreadsheet format should enable the Staff to type in a price change and instantaneously observe the effect of the price change on the weighted average price level of the affected Basket. The data in the spreadsheet shall include the following columns for each Basket:

Basket X: (Denominator or Numerator of Price Index)					
Service Name	Tariff Section	Date of Most Recent Price Change	Price	Quantity Demanded	Revenue
A	x.x	01/01/2001	\$x.xx	x,xxx	\$xx,xxx
B	x.x	01/01/2001	\$x.xx	x,xxx	\$x,xxx
TOTAL	----	----	----	----	\$xxx,xxx

This data will be fixed for calculation of the Price Index denominator at each service's price at the beginning of the Price Cap year. A second set of this same data shall be included in the spreadsheet for each Basket and will be updated with each price change throughout the year, cumulatively, in order to calculate the

Attachment A:  
Terms, Conditions and Operation of the Price Cap Plan

Price Index numerator. The Index for the Basket is calculated as the ratio of the numerator data over the denominator data, as described above for each Basket. The calculated Price Index for each Basket shall remain below the Basket's assigned Price Cap in order for rate changes to be considered lawful upon filing. The spreadsheet shall be equipped with the formula that enables instantaneous verification that a price change by Qwest is within the prescribed cap. For the initial prices, it will suffice to establish the date of most recent price change at 01/01/2001 for all services, particularly if the last price change is unknown. For each subsequent year of the Price Cap Plan, the most recent price change may be recorded as 01/01/xx, to indicate the starting price for the service in year xx.

- b) The Price Cap Database shall be updated annually, reflecting end of year prices and quantities which represent existing prices and current quantities to be used in the next year of the plan.
  - c) As individual price changes are filed, the Staff shall examine their effect on the affected Baskets' Price Index, using the Price Cap Database. If a price change results in a Price Index above the Cap, the price change does not comply with the Plan and Staff may recommend rate reductions that should occur in order to meet the constraints of the Cap.
- 6) Renewal of the Price Cap Plan
- a) The Price Cap Plan shall have an initial term of three years at the end of which Qwest may propose to either:
    - i) Renew the Price Cap Plan under the current terms and conditions; or
    - ii) Renew the Price Cap Plan with proposed revisions.
  - b) Qwest's proposal shall be filed along with other monitoring information requested at the end of the first quarter of the third year of the Price Cap Plan.
  - c) Whether and under what terms and conditions to renew the Price Cap Plan will be determined by negotiations among Staff, Qwest, and other parties subject to the Commission's approval. Contested hearings on renewal of the plan may or may not occur depending on the disposition of negotiations among parties. Nothing herein, however, shall preclude any party from requesting a hearing on the Company's proposal to renew the Price Cap Plan. Nothing herein shall affect the Commission's jurisdiction or authority to determine the most appropriate form of regulation for Qwest at the end of the three year term of the Price Cap Plan, including termination of the Plan.
- 7) Applicability of Commission Rules
- a) Unless expressly provided herein, this Price Cap Plan is not intended to alter or eliminate the application of current Commission rules and orders to Qwest.
  - b) Nothing in this Price Cap Plan is intended to change or modify in any way the imputation requirements contained in A.A.C. R14-2-1310.